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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Egypt/Libya: Pluses and Minuses of a Merged Economy

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INTELLIGENCE MEMORANDUM

EGYPT/LIBYA: PLUSES AND MINUSES OF A MERGED ECONOMY

Conclusions

1. By bringing together two complementary economies, the scheduled union of Egypt and Libya would seem to create an Arab state with a potential for economic growth second in the Middle East only to Iran. Egypt has a budding industrial base and a well-trained labor force by the standards of the area—but has mortgaged its future through lavish spending on industrial and military programs. Oil-rich Libya has a sizable export surplus and $3 billion in foreign exchange assets (see Table 1) but lacks the technical and managerial competence to mount a full-scale economic development program. A merged state presumably would replenish Egyptian coffers and speed up the modernization of Libya.

2. The agreement between Egypt and Libya, which was signed in August 1972, calls for economic and political union by September 1973. Considerable economic integration between Egypt and Libya had been evolving since World War II and was speeded up with the accession to power in 1969 of the Libyan strong man Colonel Mu'ammar Qadhafi. Egyptian officials occupying key positions in the Libyan economic ministries have promoted joint development efforts and have substantially synchronized Egyptian-Libyan financial accounts. Egyptian consumer goods are beginning to flow to Libya over lower tariff barriers. Underemployed Egyptian technicians and workers reportedly are moving into Libya at a rate of more than 2,000 a week.

3. In spite of the complementarity of the two economies and the recent history of growing economic interdependence, the proposed union would hardly be an economic panacea:

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

a. Libya, as a conservation measure and bargaining weapon, has curtailed oil output to such an extent that its annual accumulation of hard currency assets may well drop to near zero in 1973, compared with $410 million in 1972 and $860 million in 1971. At present oil output levels, the merged state will incur a current account deficit unless spending plans are curtailed.

b. If Qadhafi's passionate anti-Communism prevails after union, Soviet assistance to the merged state could be curtailed. In this event, the new state might be forced to seek sizable new Western credits and/or increase output from the Libyan oilfields.

c. Joint economic development within the merged state would be hampered by the stifling effect of the overblown Egyptian bureaucracy, by the natural Libyan resentment of Egyptian carpetbaggers, and by the continued frustrations and costs of the Arab-Israeli confrontation.

Introduction

4. The agreement of President Sadat and Colonel Qadhafi to unify Egypt and Libya, if implemented, would create a new regional power with an area of more than one million square miles, a population of almost 40 million, and ready financial reserves of $3 billion.[1] The union would culminate an era of increasingly close economic and political cooperation. At this juncture, the emergence of a fully-functioning merged state by September 1973 appears unlikely. The chances that some form of unity will result, however, are great enough to warrant examination of the substantial economic implications. This memorandum traces the course of Egyptian/Libyan economic collaboration in the past, discusses the prospects for **de facto** economic integration, and delineates the probable economic and financial consequences of a political union.

1. Libya would bring $3 billion in ready reserves to the union, whereas Egypt's obligations of $3 billion would become due only at various dates in the future.

Table 1

Egypt and Libya: Economic Comparisons

Item	Unit	Egypt	Libya
Area	Square miles	368,000[a]	679,000
Population	Million	35	2
Railroads	Miles	3,000	none
Electric power production (1971)	Billion kilowatt-hours	8	0.8
Gross national product (1971)	Billion US $	6	3
Gross national product per capita (1971)	US $	175	1,500
Exports (1971)	Billion US $	0.82[b]	2.71[c d]
Imports (1971)	Billion US $	1.22[b]	0.64[d]
Net foreign assets (1972)	Billion US $	-3	3

a. Including 22,000 square miles occupied by Israel.
b. Fiscal year ending 30 June 1971.
c. More than 99% petroleum.
d. Estimated on the basis of nine months' data.

Discussion

Egypt and Idris

5. Egyptian/Libyan economic relations had developed gradually up to the 1969 Libyan coup despite marked social and political animosity. The Idris monarchy, wealthy, Western oriented, and corrupt, typified the kind of regime

scorned by the Nasir government. Idris for his part neither liked nor trusted his eastern neighbor, and his dislike was shared by most Libyans. [redacted] 25X6 geographic proximity and economic complementarity prompted a rising level of economic relations between their two countries.

6. Egypt's superiority in human resources provided the initial impetus for development of Egyptian/Libyan economic relations. Libya was forced to look to Egypt—the only Arab country with a surplus of "expertise"—for Arabic speaking teachers and other professional personnel. The Egyptian government, committed to providing "make work" jobs in the bureaucracy for the urban population, encouraged employment of Egyptians in Libya. Demand in Libya for imported skills escalated rapidly after oil production began in 1962. By the mid-1960s, 18,000 aliens were being employed, including some 4,500 official Egyptian technical personnel and an unknown number of Egyptian businessmen and laborers. Egypt benefited as well, both from the removal of potential malcontents from Egyptian cities and from the steady inflow of personal savings from abroad.

7. Among the chief beneficiaries of Libya's growing wealth were the large construction companies that make up Egypt's only important private sector. Egyptian firms quickly gained contracts in public housing and in sanitary engineering, although they were not capable of competing against Western firms for large public works projects. At least one company, Osman Ahmed Osman (the firm chiefly associated with construction of the Aswan High Dam), was successful enough in Libya to justify forming a subsidiary, the Arab Construction Company. Burgeoning activity in Libya helped other Egyptian firms by cushioning the impact of the depression in the Egyptian construction industry that followed the completion of the Aswan High Dam.

8. Merchandise transactions between the two countries were insignificant during the 1960s, at no time constituting more than 1% of either's total trade. Tastes in Libya remained for many years after independence oriented toward the goods of Italy. This common post-colonial tendency was particularly strong in Libya, where independence was not followed by a repatriation of the Italian population. Many urban services, including importing and retailing, continued to be provided predominantly by Italians, who were uninterested in Egyptian goods. Libya's only significant export, crude oil, was of minor interest to Egypt because the bulk of Egypt's refining capacity was in Suez. Egypt purchased Metiterranean crude oil only for the small (30,000 barrels per day) Alexandria refinery.

9. The Arab/Israeli war in 1967 substantially altered the Egyptian/Libyan economic relationship. Before the war, Egypt had been the donor, providing technical assistance to Libya. After the war, Idris, who was

notoriously parsimonious in sharing his growing oil revenues with other Arab states, came under considerable pressure to help replace the war losses of the front-line nations. He responded initially by granting Egypt about $30 million. At the Khartoum conference in the fall of 1967, Libya was assessed $84 million annually, of which $59 million was earmarked for Egypt. Saudi Arabia and Kuwait offered $140 million and $123 million, respectively, in annual subsidies to Egypt and Jordan. Nasir subsequently managed to obtain from Libya an additional one-time grant of $56 million, of which $28 million had been disbursed when Idris was deposed. Despite this **ad hoc** disbursement, annual aid to Egypt from Libya under Idris never equaled the contributions of other affluent Arab states.

Post-Coup Relations

10. The 1969 coup that brought Qadhafi and the Revolutionary Command Council (RCC) to power in Libya transformed the political climate in which Egypt and Libya conducted economic relations. Initially the most important factor in the change was Qadhafi's personal devotion to Gamal Abdul Nasir. Since Nasir's death, Qadhafi has continued to view Egypt as the standard bearer in the "Holy War" against Israel and as the focal point of his Pan-Arabist ambitions. This political affinity has fostered the development of a complex web of economic relationships.

The Client State Relationship

11. Upon assuming power, Qadhafi honored the financial commitment to Egypt of the Idris regime and began to supplement the annual dole generously. By the end of 1970, more than $160 million in **ad hoc** aid had been transferred, bringing total aid for that year to more than $220 million. Similarly in 1971, Egypt received from Libya at least $140 million over and above the pledged Khartoum aid, or a total of at least $200 million. Qadhafi disbursed aid to more than 20 clients during his first two years in power, with aid to Egypt constituting 30% of the total. For Egypt this extra aid was the chief means of covering a hard currency deficit, which had been aggravated by rising imports and declining receipts from petroleum.

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[redacted]

Egypt's Role in Libya

14. Libya has benefited from the post-coup association with Egypt, contrary to reports in the press and elsewhere. Qadhafi's intense suspicion of both the "imperialistic" West and the atheistic East has severely restricted Libyan access to foreign expertise. At the same time, the boundless political and economic ambitions of the new government require considerable technical assistance from abroad. Given the minimal technical ability of the Libyan population, the RCC almost certainly would have been frustrated on all fronts without Egyptian help. The Egyptians serving in Libya have the considerable advantages of speaking a common language (Arabic), practicing a common religion (Islam), and being almost indistinguishable to outsiders.

15. The influx of Egyptian technicians into Libya began almost immediately after the coup, the initial contingent consisting of troops sent by Nasir to secure the position of the RCC. Subsequently, Egypt sent technicians to assist Libyans with Soviet arms [redacted] 25X1

16. All available reports indicate that the Libyan labor force has been Egyptianized to an impressive degree, as shown in the tabulation:

	Before Coup (1964-65)[a]	Estimated After Coup (1971-72)[a]
Total labor force	**400,000**	**540,000**
Libyans[b]	382,000	480,000
Aliens	18,000	60,000
Egyptian	4,500	50,000
Italian	3,000	Negl.
Others	10,500	10,000

a. Including data from both years.
b. Of which at least 10% are unemployed.

If Egyptian workers are joined by their families, Egyptians could make up about 10% of the total population. In urban areas, Egyptians constitute a far higher percentage of both the population and labor force and may represent half or more of the professional class outside the military.

17. In the past, most of the movement of Egyptians to Libya was the result of assignments or job offers under government-to-government agreements; recently unofficial Egyptian immigration also has been encouraged by the RCC. In 1972 a Libyan decree established roughly equal rights and benefits for Egyptians and Libyans working in Libya. [redacted] 25X1

[redacted] 25X1

18. Considerable Egyptianization of Libyan institutions and planning also has taken place. Egyptian advice undoubtedly is behind the prominence of land reclamation and electric power development in the new Libyan three-year plan. These kinds of projects have claimed a sizable share of development spending in Egyptian plans. The most recent Libyan state budget (fiscal year 1973) was clearly the work of Egyptian advisers, following the format adopted a decade ago by Egypt.

19. The Egyptians also have benefited from their prominent role in Libyan affairs. In at least three instances, proposed development projects in

Egypt have become "joint" projects, with Libya providing the cash and presumably sharing in the benefits. The first is a joint water project through which Libya would receive some water from the Nile[2] in return for financing an extension of the Nubayriyah Canal. The second proposal is a joint thermal (possibly nuclear) generating plant to be financed by Libya. In the third case, Libya has assumed a share in the Arab International Bank (formerly the Egyptian International Bank), which was originally designed to obtain foreign private investment for Egypt. Egyptian private companies have a strong position in housing, agricultural development, and sewerage, development areas dominated by Egyptian governmental advisers (see Table 2).

Table 2

Participation of Egyptian Private Firms in Libyan Development

Area	Value of Contracts Let (Million US $)	Egyptian Share (Percent)
Industrial projects	65	0
Electric power and desalination	62	0
Miscellaneous civil construction	25	0
Airports	22	0
Hospitals and clinics	67	0
Sewerage	24	20
Agricultural development	20	50
Petroleum and petrochemicals	29	0
Television and telecommunication	14	0
Roads and bridges	52	8
Housing	17	100

Economic Unity?

The Case for Creeping Integration

20. Regardless of how slowly political union may be implemented, a strong impetus toward economic integration will persist. The economic complementarity that has promoted increasing economic collaboration in the past is being reinforced by legislative action in Libya and by growing economic

2. It is unclear where the extra water is to come from. Egypt had insufficient water to accomplish its own agricultural expansion and hydroelectric power generating goals.

interdependence. The drift toward economic unity could be checked by a political rupture. A number of issues are sufficiently volatile to bring further unity efforts to a halt. The most important are the conduct of the war with Israel and Egypt's relationship with the USSR. Public reaction to overly hasty moves toward unity could also prove disruptive, even to the point of unseating either Sadat or Qadhafi or forcing a pullback from the level of integration already achieved.

21. Even though the greatest enthusiasm for unity is generally attributed to Qadhafi, Egypt's urgent need for funds could prove an even stronger incentive for integration. Libyan arms purchases probably are viewed by Egypt as a possible alternative to Soviet military aid. However, if Libya devotes all financial support beyond the Khartoum payments to the purchase of arms for Egypt, then Cairo will be faced with a shortfall in untied current receipts of at least $100 million and with the prospect of sharply curtailing non-military expenditure plans (see Table 3). Since Qadhafi is no longer inclined to provide

Table 3

Post-Coup Libyan Aid to Egypt

Million US $

	1970	1971	1972 Estimated
Untied balance-of-payments support	225-239	159-209	59
Annual subsidy	59	59	59
Ad hoc support	166-180	100-150	--
Tied to arms purchase	0	40	100-350
Total	**225-239**	**199-249**	**159-409**

untied aid to any client, integration of Egyptian and Libyan economic plans may be the only means of maintaining investment levels in Egypt and of improving Egypt's dismal credit rating.

22. Libya needs additional expertise from Egypt if the ambitious goals of the current Libyan economic plan are to be attained. Qadhafi undoubtedly will continue to let a large number of contracts to Western firms and will allow them to recruit a temporary labor force from abroad. The need for

administrators and advisers in the Libyan bureaucracy will escalate in parallel fashion. Egypt continues to be the only available and acceptable source for these latter persons. To make sure a proper staff is available, the Libyans recently signed a labor pact that obliges the Egyptian Ministry of Labor to fill all gaps in the Libyan labor force and civil service on request from the Libyan labor department.

23. The stage is also set for considerable expansion in Egyptian/Libyan trade, possibly leading to integration of the two domestic markets. Last year the RCC drastically revised Libyan trade regulations. A new tariff structure favors goods from Arab countries. The chief beneficiary should be Egypt, which has the advantages of proximity, a large consumer population resident in Libya, and the most highly developed industrial sector in the Arab world. In view of Libya's oil-fueled prosperity, Egyptian sales will be limited mainly by the extent to which the lethargic and cumbersome state industrial bureaucracy can respond to new opportunity. Egypt should now be able to expand sales to Libya of textiles, clothing, footwear, motor buses, drugs and pharmaceuticals, and consumer durables (refrigerators, radios, television sets, furniture). The development of the Libyan market would be important if Soviet/Egyptian trade diminished as the result of Egyptian/Libyan plans for union. Many of the goods sold to the USSR could not be sold in Western Europe, because of tariff barriers and problems with quality, or in Africa, because of Africa's low purchasing power. Egypt, which has suffered a decline in output of crude oil, could become a major customer for Libya's fledgling state oil company, LINOCo. Moreover, when the planned expansion of refining capacity for LINOCo is completed, Egypt may prefer to rely on Libya for the range of petroleum products now imported from the USSR.

Economic Implications of Complete Unity

24. If unity is consummated in September 1973 as scheduled, major economic problems in both countries would be relieved. The foreign exchange shortage in Egypt, which has curbed economic progress for more than a decade, would be mitigated, at least temporarily. As for Libya, access to Egypt's relatively advanced industrial sector would represent a giant step toward the creation of a viable non-oil economy. Solutions to economic problems, however, may be either short term or less complete than either side expects. Moreover, some basic economic objectives and important economic tactics in both countries would have to be modified.

25. Libya's income from oil, although enormous by Egyptian standards, will not provide a panacea for Cairo's economic woes. Libya's own expenditure plans are expected to absorb current levels of oil income by late 1973, assuming a constant level of foreign aid (see Table 4). Thus the $3 billion in foreign exchange assets that Libya would bring to the union no longer would be augmented unless the current oil policy of the Qadhafi regime is revised.

Table 4

Libyan Balance of Payments

Million US $

	1969	1970[a]	1971[b]	1972[b]	1973[b]
Oil revenues[c]	970	1,500	1,900	1,600	1,300
Local expenditures by oil companies	316	110	110	110	110
Imports and net services					
Military	-26	N.A.	-140	-140	-140
Non-military	-760	-638	-640[d]	-800[e]	-900[e]
Foreign aid	-122	-350	-370	-360	-360
Reserve accumulation[f]	378	622	860	410	10

a. Preliminary.
b. Estimated.
c. Excluding bartered oil. Other foreign exchange earnings are negligible.
d. Based on nine months' data.
e. All investment budget expended, 30% for imports; other imports constant.
f. Excluding "soft currency" reserves and hence does not correspond to published figures.

26. At the same time, Cairo's financial needs almost certainly are rising. Egypt's economic plan, scheduled to begin in January 1973, will require an additional $225 million annually in capital goods imports. In addition, personal consumption in Egypt almost certainly will rise much faster than the increase in output of domestic goods because of continuing population increases, the catching up with deferred demand, and the demonstration effect of Libya's affluent middle and upper-middle class. Once the merged state is formed, Saudi Arabia and Kuwait could discontinue subsidies to Egypt, increasing the Egyptian current account deficit by as much as $190 million annually (see Table 5). As still another difficulty, Libya might insist on Egypt's terminating its client-state relationship with the USSR. In this case, it would cost Egypt about $100 million annually to maintain the present military machine. Finally, if spare parts could not be obtained for Soviet equipment, replacements could easily involve an annual outlay of $350 million.[3]

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Table 5

Hypothetical Joint Egyptian/Libyan
Current Account Balance, 1974

	Million US $ 1974
I. Libyan balance	
A. At current oil output levels	0
B. At "optimum" oil output levels	730
II. Financing required by Egypt	-530 to -780
Of which:	
Present subsidies from Saudi Arabia and Kuwait	191
Incremental	
Investment	225
Consumption	14
Arms	100 to 350
Balance No. 1 (IA + II)	-530 to -780
Of which non-military	-430
Balance No. 2 (IB + II)	200 to -50

27. The combined net effect of these potential changes in Egypt's receipts and spending could be a current account deficit of as much as $780 million, an amount equal to one-fourth of Libya's foreign exchange reserves. In the short run, the credit rating of the new merged state could be respectable in spite of Egypt's spendthrift past and Libya's quixotic reputation. Enough credit conceivably could be forthcoming from Western and international sources to cover most of the projected $430 million non-military deficit, leaving possibly $100 million to $350 million annually in military spending to be financed out of Libya's reserves. The extent to which credit will be employed, however, may be limited by Qadhafi's strict belief in the Muslim prohibition of usury. Thus far, he has generally been unwilling to incur any interest bearing debt on Libya's behalf.

28. Whatever the credit situation may be, neither partner in the merged state is likely to consider cutting expenditures to conserve reserves. Qadhafi normally is prepared to sacrifice domestic economic prospects to achieve external political goals, but neither the Egyptians nor other RCC members would be likely to curb development plans to preserve the merged state's financial "muscle" in world affairs. The curtailment of Libya's $300 million to $400 million foreign aid program would have a negligible impact because only the two prime clients, Egypt and the Fedayeen, now receive significant amounts of grant aid. Most other disbursements take the form of loans or temporary deposits.

29. The need for increased revenues would be likely to create considerable pressure to increase Libyan oil output. Libya is now producing only about 2 million barrels per day, or 1.7 million less than during the peak output in April 1970. An output of 3 million barrels per day could generate additional revenues of $730 million a year. Oil men appear to agree with the Libyan government that an output above 3 million barrels per day would require considerable additional investment, which in the atmosphere prevailing in 1972 appeared unlikely to become available.

30. The options of the merged state in negotiating with the foreign oil companies will be substantially restricted. Libya's present strong bargaining position on the issues of participation and nationalization is based on a capability to live as long as three years on accumulated foreign exchange reserves. Any pressures for increased Libyan output or a rapid drawdown of Libyan financial reserves will reduce the flexibility now enjoyed by Libya. Moreover, the attitudes of the Egyptians and Libyans toward the foreign oil companies differ. Although Egypt's oil industry is dominated by joint venture arrangements similar to those now being sought by Libya, Egypt's arrangements were achieved in lieu of concession agreements rather than being wrested from operating companies through negotiation or confiscation.

31. Prospective Egyptian actions with regard to the private sector may also be modified by the proposed union. The Sadat regime has authorized encouragement of private foreign investment in Egypt, a reversal of the drift toward complete socialism of the past two decades. The Libyans, now in the process of duplicating Egypt's earlier history, are moving toward state ownership and may view the Egyptian trend with alarm. Under the merged state, Cairo no doubt would soft pedal the new trend because of the expected easing of the foreign exchange shortage. [redacted] 25X1

32. Other difficulties would face the merged state:

a. The influx of Egyptians into Libya can only partly relieve the problem of underemployment of Egypt's educated middle class; yet the numbers are extremely large by Libya's standards. Notwithstanding the identity of language and religion, Libyans are bound to be increasingly resentful of the growing number of outsiders who are filling the best positions in their society.

b. The Arab-Israeli confrontation will continue to be a political frustration and an economic drain. The energies of the leadership and the financial resources of the merged state will go to the purchase of modern weapons rather than to industrial development and improvement in living standards.

c. The volatility of political leadership in the whole area—witness the previous divorces of Egypt and Syria as well as of Egypt and Yemen—suggests that a merged state would founder quickly. The proposed political organization has not yet been announced, but almost any administratively workable arrangement would leave at loose ends numerous high-level and presumably disgruntled elements in both former states. The potential for a political explosion could be so great that economic advantages of the union could be forgotten by both sides.